

Internal Revenue Service, Treasury

§ 1.662(c)-4

(c) The distributable net income of the trust as computed under section 643(a) is \$82,750, determined as follows:

Rents		\$50,000
Dividends		50,000
Partially tax-exempt interest		10,000
Tax-exempt interest	\$20,000	
Less:		
Trustee's commissions allocable thereto (20,000/130,000 of \$3,900)	\$600	
Charitable contributions allocable thereto (20,000/130,000 of \$27,950)	4,300	
		<u>4,900</u>
		15,100
Total		125,100
Deductions:		
Rental expenses	15,400	
Trustee's commissions (\$3,900 less \$600 allocated to tax-exempt interest)	3,300	
Charitable deduction (\$27,950 less \$4,300 attributable to tax-exempt interest)	23,650	
		<u>42,350</u>
Distributable net income		82,750

In computing the distributable net income of \$82,750, the taxable income of the trust was computed with the following modifications: No deductions were allowed for distributions to beneficiaries and for personal exemption of the trust (section 643(a) (1) and (2)); capital gains were excluded and no deduction under section 1202 (relating to the 50 percent deduction for long-term capital gains) was taken into account (section 643(a)(3)); and the tax-exempt interest (as adjusted for expenses and charitable contributions) and the dividend exclusion of \$50 were included (section 643(a) (5) and (7)).

(d) Inasmuch as the distributable net income of \$82,750 as determined under section 643(a) is less than the sum of the amounts distributed to W and D of \$83,850, the deduction allowable to the trust under section 661(a) is such distributable net income as modified under section 661(c) to exclude therefrom the items of income not included in the gross income of the trust, as follows:

Distributable net income	\$82,750
Less:	
Tax-exempt interest (as adjusted for expenses and the charitable contributions)	\$15,100
Dividend exclusion allowable under section 116	50
	<u>15,150</u>
Deduction allowable under section 661(a)	67,600

(e) For the purpose of determining the character of the amounts deductible under section 642(c) and section 661(a), the trustee elected to offset the trustee's commissions (other than the portion required to be allocated to tax-exempt interest) against the rental income. The following table shows the determination of the character of the amounts deemed distributed to beneficiaries and contributed to charity.

	Rents	Taxable dividends	Excluded dividends	Tax exempt interest	Partially tax exempt interest	Total
Trust income	\$50,000	\$49,950	\$50	\$20,000	\$10,000	\$130,000
Less:						
Charitable contribution	10,750	10,750		4,300	2,150	27,950
Rental expenses	15,400					15,400
Trustee's commissions	3,300			600		3,900
Total deductions	29,450	10,750	0	4,900	2,150	47,250
Amounts distributable to beneficiaries	20,550	39,200	50	15,100	7,850	82,750

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The character of the charitable contribution is determined by multiplying the total charitable contribution (\$27,950) by a fraction consisting of each item of trust income, respectively, over the total trust income, except that no part of the dividends excluded from gross income are deemed included in the charitable contribution. For example, the charitable contribution is deemed to consist of rents of \$10,750 ($50,000/130,000 \times \$27,950$).

(f) The taxable income of the trust is \$9,900 determined as follows:

Rental income	\$50,000
Dividends (\$50,000 less \$50 exclusion)	49,950
Partially tax-exempt interest	10,000
Capital gains	20,000
Gross income	129,950
Deductions:	
Rental expenses	15,400
Trustee's commissions	3,300
Charitable contributions	23,650
Capital gain deduction	10,000
Distributions to beneficiaries	67,600
Personal exemption	100
	<hr/>
	120,050
Taxable income	9,900

(g) In computing the amount includible in W's gross income under section 662(a)(1), the \$55,900 distribution to her is deemed to be composed of the following proportions of the items of income deemed to have been distributed to the beneficiaries by the trust (see paragraph (e) of this example):

Rents ($20,550/82,750 \times \$55,900$)	\$13,882
Dividends ($39,250/82,750 \times \$55,900$)	26,515
Partially tax-exempt interest ($7,850/82,750 \times \$55,900$)	5,303
Tax-exempt interest ($15,100/82,750 \times \$55,900$)	10,200
Total	55,900

Accordingly, W will exclude \$10,200 of tax-exempt interest from gross income and will receive the credits and exclusion for dividends received and for partially tax-exempt interest provided in sections 34, 116, and 35, respectively, with respect to the dividends and partially tax-exempt interest deemed to have been distributed to her, her share of the dividends being aggregated with other dividends received by her for purposes of the dividend credit and exclusion. In addition, she may deduct a share of the depreciation deduction proportionate to the trust income allocable to her; that is, one-half of the total depreciation deduction, or \$5,000.

(h) Inasmuch as the sum of the amount of income required to be distributed currently to W (\$55,900) and the other amounts properly paid, credited, or required to be distributed to D (\$27,950) exceeds the distributable net income (\$82,750) of the trust as determined under section 643(a), D is deemed to have received \$26,850 (\$82,750 less \$55,900) for income tax purposes. The character of the

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amounts deemed distributed to her is determined as follows:

Rents ($20,550/82,750 \times \$26,850$)	\$6,668
Dividends ($39,250/82,750 \times \$26,850$)	12,735
Partially tax-exempt interest ($7,850/82,750 \times \$26,850$)	2,547
Tax-exempt interest ($15,100/82,750 \times \$26,850$)	4,900
Total	26,850

Accordingly, D will exclude \$4,900 of tax-exempt interest from gross income and will receive the credits and exclusion for dividends received and for partially tax-exempt interest provided in sections 34, 116, and 35, respectively, with respect to the dividends and partially tax-exempt interest deemed to have been distributed to her, her share of the dividends being aggregated with other dividends received by her for purposes of the dividend credit and exclusion. In addition, she may deduct a share of the depreciation deduction proportionate to the trust income allocable to her; that is, one-fourth of the total depreciation deduction, or \$2,500.

(i) [Reserved]

(j) The remaining \$2,500 of the depreciation deduction is allocated to the amount distributed to charity X and is hence non-deductible by the trust, W, or D. (See § 1.642(e)-1.)

§ 1.663(a)-1 Special rules applicable to sections 661 and 662; exclusions; gifts, bequests, etc.

(a) *In general.* A gift or bequest of a specific sum of money or of specific property, which is required by the specific terms of the will or trust instrument and is properly paid or credited to a beneficiary, is not allowed as a deduction to an estate or trust under section 661 and is not included in the gross income of a beneficiary under section 662, unless under the terms of the will or trust instrument the gift or bequest is to be paid or credited to the recipient in more than three installments. Thus, in order for a gift or bequest to be excludable from the gross income of the recipient, (1) it must qualify as a gift or bequest of a specific sum of money or of specific property (see paragraph (b) of this section), and (2) the terms of the governing instrument must not provide for its payment in more than three installments (see paragraph (c) of this section). The date when the estate came into existence or the date when the trust was created is immaterial.

(b) *Definition of a gift or bequest of a specific sum of money or of specific property.* (1) In order to qualify as a gift or